Submission to Ministry of Business, Innovation and Employment

Woolworths New Zealand Limited

Review Of Anti-Competitive Land Agreements

25 August 2023

INTRODUCTION

1. This submission to the Ministry of Business, Innovation & Employment ("**MBIE**") is made by Woolworths New Zealand Limited ("**WWNZ**") on the review into the use of anti-competitive land agreements. It is a general submission, but responds broadly to the following questions put forward by MBIE in its discussion document:

39	Are there any other risks or potential unintended consequences you would like us to be aware of?
40	Do you consider existing provisions in the Commerce Act have the potential to 'overcapture' land agreements, by prohibiting land agreements you consider to have necessary purpose? Please provide examples.
41	Do you consider the ability of the Commerce Commission to provide 'authorisation' sufficient to mitigate the risk that the Commerce Act could over-capture land agreements? If not, why not?

ABOUT WOOLWORTHS

2. WWNZ owns and operates over 190 Countdown supermarkets. We are also the franchisor for 72 SuperValue and FreshChoice supermarkets, which are locally owned and operated businesses. We employ more than 22,000 team members throughout the country in our supermarkets, distribution centres, and central support offices.

SUMMARY OF WWNZ'S SUBMISSION

3. As a designated grocery retailer, WWNZ has been subject to sections 28A – 28D of the Commerce Act 1986 ("**Act**") since 30 June 2022. These provisions ("**Amendments**") were introduced by the Commerce (Grocery Sector Covenants) Amendment Act 2022 following recommendations made by the Commerce Commission ("**Commission**") in the market study into the grocery sector. To comply with the Amendments, WWNZ has been undergoing a systematic process of identifying and removing covenants captured by (or which might arguably be captured by) s 28A. WWNZ is therefore able to speak to the effects, intended or otherwise, of the Amendments and the ways in which they might be improved.

4. WWNZ supports legislation that will apply on a fair and consistent basis across the wider economy that will prohibit or restrict anti-competitive land agreements. It considers that changing sections 27 and 28, such as by adding deeming provisions (as in the case of the Amendments), could be an effective way of deterring or prohibiting anti-competitive land agreements. However, WWNZ has a number of concerns with the way the Amendments have been drafted and it is keen to see the wider economy avoid similar pitfalls if similar legislation is to be introduced for all sectors.

5. WWNZ's three key concerns in relation to the Amendments, which it considers need to be avoided in any new legislation in relation to land agreements in the wider economy, are that:

   (a) they are drafted so broadly that they could be argued (contrary to the spirit and intent of the legislation) to capture a number of legitimate covenants and provisions in leases (such as provisions that provide for pedestrian access ways and customer amenities), and therefore have a chilling effect on the entry into and enforcement of those legitimate covenants and provisions that are actually in consumers' interests;

   (b) they prohibit rights of first refusal, which are commonplace, not anti-competitive, and, in fact, serve legitimate interests which should be protected; and

   (c) under s 28A(6), the Commission is required to consider the deemed (rather than actual or likely) anti-competitive effects of a covenant in an application for authorisation. This significantly hampers the authorisation regime's ability to act as a safety-valve to enable covenants that are in the public interest. In particular, because the Commission is required to evaluate potential benefits to the public against any *deemed* (but not necessarily actual or likely) anti-competitive effects of such covenants, it is possible that the Commission determines that the *actual* benefits outweigh the *actual* detriments, but it is nonetheless unable to authorise the covenant.

6. In addition, WWNZ considers that it would be beneficial to allow land agreements which promote and protect new developments, for example by the inclusion of a legitimate business interest exception. The exception could be similar to analogous protections including in the Fair Trading Act 1986 ("**Fair Trading Act"**) which requires the Court to consider whether conduct / contractual terms are reasonably necessary for the protection of the trader's legitimate interests" when considering the prohibitions on unconscionable conduct and "unfair contract terms".

7. We expand on these concerns, as well as the benefits of allowing covenants / land agreements justified by legitimate business rationales, below.

UNINTENDED CONSEQUENCES OF SECTION 28A

8. This section addresses questions 39 and 40 put forward by MBIE regarding the potential unintended consequences of the Act, including the potential for existing provisions in the Act to 'over-capture' land agreements. The submissions in this section are also provided against the backdrop of question 37, and the suggestion in the discussion document that options could include widening the prohibitions created for groceries to include other sectors.

9. As mentioned above, WWNZ considers that changes to s 27 and 28 of the Act (including adding deeming provisions) could be an effective way to deter or prohibit anti-competitive land agreements. However, it considers that such changes should be carefully drafted to avoid unintended consequences, particularly 'over-capture' of land agreements that have a legitimate and necessary purpose, including, for example, rights of first refusal and land agreements of

limited duration. In particular, it suggests that the language used in s 28A be avoided for any new legislation (and, perhaps, revisited in respect of the grocery sector – including potentially through new legislation that will apply consistently across all sectors).

10. The language that is currently used in section 28A results in a very broad range of covenants (ie land agreements) being captured by the section, which results in significant unintended consequences. We also note that the prohibitions in section 28A go significantly further than the equivalent restrictions in Australia on "restrictive provisions" in supermarket lease agreements.[1] The Australian Competition and Consumer Commission ("**ACCC**") considers the Australian approach has been successful in "creating more competition and leading to lower prices for consumers",[2] and does so without the complexity and risk of 'over-capture' of the approach taken in New Zealand through section 28A.

11. As it currently stands, under section 28A covenants are *per se* illegal and unenforceable (and their enforcement could result in the imposition of significant pecuniary penalties) if:

    (a) in respect of "restrictive covenants" (which captures covenants in leases), they have the effect or likely effect of *impeding* the development or use of land or a site as a retail grocery store or any other retail store that is likely to compete with a retail grocery store operated by the designated grocery retailer (ie "a competing business"); and

    (b) in respect of "exclusivity covenants" or other provisions in leases, they have the effect or likely effect of *impeding* another person from operating a competing business.

12. The reference to the concept of "impeding" creates uncertainty as to what the Amendments capture. On one view, "exclusivity covenant" could (contrary to the spirit and intent of the legislation) be read as extending to provisions that secure essential amenities to an existing supermarket, for example, access and carparking. At the extreme end, it could be argued to also capture exclusive possession and/or an exclusive right to use a designated area under a lease, rights of renewal, or permitted use provisions in a lease.

13. The term "impede" is commonly understood to be synonymous with terms such as "slow [down]", "hinder" or "obstruct". That is a low bar, and WWNZ believes the current expression of the applicable effects-based test is capable of being argued to unintentionally capture a broad range of legitimate property arrangements which require that land be used for a particular purpose, or which protect certain features of that land. For example:

    (a) Access routes are commonly shared with other retailers and customers at the same shopping centre, and form part of common areas. These may be protected by registered easements (particularly if the shopping centre is not in single common ownership) but may also be protected by lease provisions requiring that certain areas are maintained as access routes. These routes are typically protected in lease arrangements to preserve both the operational efficiency and the safe use of access routes and loading zones so that these are separated from pedestrian traffic, the traffic effects of the supermarket are managed, and customers can circulate through the common carparks with ease.

    (b) It is common to include provisions in leases which require that the lessor make certain common areas available for carparks, or that the lessor provide certain minimum carpark ratio requirements across the entirety of a shopping centre, to provide sufficient

[1] Which have been established in Australia by way of court enforceable undertakings as between supermarkets and the ACCC. See: (18 September 2009). Supermarket agreement opens way for more competition. ACCC. Retrieved from: https://www.accc.gov.au/media-release/supermarket-agreement-opens-way-for-more-competition

[2] Commitment Decisions in Antitrust Cases. Note by Australia. 15 – 17 June 2016.

carparking facilities for customers. These provisions are important for delivering a convenient and safe shopping experience for customers, and often included as conditions of consent.

(c) Easements over neighbouring land may be required to secure necessary services to and from the leased premises, for example utilities, stormwater, wastewater and the like. In some cases, these easements may also operate as an access route to the supermarket site.

(d) Similarly, trolley bays, services infrastructure, pedestrian circulation areas etc that provide amenity and other benefits to lessees and their customers, which are not being used exclusively by the lessee.

14. These arrangements all protect legitimate commercial and customer interests, but also (arguably) "impede" (on a broad interpretation) the use of the affected land for a competing business (or for any other use, for that matter).

15. Leases also often contain provisions restricting or managing development activities, requiring noisy, dusty or otherwise disruptive works to be carried out outside of peak trading hours. Again, these protect a legitimate commercial interest, but could be read as "impeding" the development of land for a competing business.

16. WWNZ has also encountered difficulties in the context of acquiring a new supermarket site which forms part of a mixed-use development where a developer has insisted on the inclusion of "no retail" covenants on the surrounding residential lots. While such covenants are not anti-competitive, are at the developer's insistence, and are intended to preserve the carefully planned commercial-residential mix of the particular neighbourhood, they are, on the face of them, captured by section 28A.

17. The effect of a deeming provision is that certain conduct is automatically a breach of the Commerce Act (and therefore subject to potentially significant consequences, such as the imposition of pecuniary penalties). In light of this, any deeming provisions in legislation that seek to prohibit or restrict land agreements in the wider economy need to be carefully defined, and should always be subject to a legitimate business rationale exception (see further at paragraphs 20 to 22 below).

Right of first refusal should not be prohibited

18. As it currently stands, section 28A(4) of the Act defines exclusivity covenant as including, without limitation, a right of first refusal ("**ROFR**").

19. ROFRs should not be *per se* prohibited because they can serve legitimate interests that need to be protected, and are commonplace across a range of different industries. For example:

(a) In relation to a ROFR to purchase premises, this is to provide a lessee with a degree of certainty as to ongoing rights of tenure, including to enable investment in their premises (including often considerable capital investment in fit-out and establishing a presence in the community) in the knowledge that they will have the first opportunity to purchase the premises on terms set by the current lessor or the same terms that a third party is prepared to offer. If the lessee is not prepared to accept the lessor's terms or the price and terms offered by a third party, then it passes up that opportunity, and the premises become available to be purchased by a third party on terms no more favourable than those offered to the lessee. Accordingly, such provisions enable investment in retail premises and presence by providing opportunities to secure ongoing tenure (if desired), and so are pro-competitive.

(b) Similarly, a ROFR to take a further lease (or to lease other suitable premises at the retail centre, or to lease any replacement premises in the event that the premises are destroyed and new premises are constructed) is to provide a lessee with a degree of certainty as to ongoing rights of tenure, including to enable investment in their premises (including, as noted above, often considerable capital investment in fit-out and establishing a presence in the community) in the knowledge that they will have with the first opportunity take a further lease at market terms. If the lessee does not accept those terms then the premises are available to be leased by another party on those terms (or on terms no more favourable). Again, such provisions enable investment in retail premises and presence (and so are pro-competitive), and are commonplace across a range of industries. Indeed, the Courts in Australia have determined that such provisions protect legitimate interests of a lessee and are not motivated by anti-competitive rationale:[3]

> The Enforceable Undertaking [to the ACCC] was aimed at restrictive provisions that had the potential to reduce competition. That is clear from the recital that the [ACCC] was conducting an industry-wide investigation into whether restrictive provisions could have the purpose or effect of substantially lessening competition in a market. The object of cl 2.5 [a ROFR clause] was not to exclude competitors of Woolworths from the Kiaora Lane Building. Rather, its object was to give Woolworths the opportunity to re-acquire the interest in the Subject Premises that it had under the Development Deed.
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> Immediately prior to entering into the Deed of Agreement, Woolworths had a right to take a lease of the Subject Premises under the Development Deed. Woolworths had invested significant resources in the development of the Development Site. Under the Deed of Agreement, Woolworths simply agreed to surrender its right to take a lease of the Subject Premises from the Council, in return for which it received a right to take the Lease back on whatever terms About Life wished to dispose of it in the future. Thus, cl 2.5 did no more than give Woolworths the opportunity to restore itself to the position that it occupied under the Development Deed, but only if About Life intended to dispose of the Lease and Woolworths was prepared to match the terms of that intended disposal.

THERE SHOULD BE AN EXCEPTION FOR COVENANTS THAT HAVE A LEGITIMATE BUSINESS RATIONALE

20. MBIE has also sought views on whether there are alternatives or less restrictive means than a deeming provision to achieve the aim of preventing anti-competitive covenants.

21. WWNZ is of the view that however any prohibition is framed, it is necessary to include a legitimate business rationale exception. That is because (as outlined above) there are many legitimate reasons why a party may require a land covenant - and often they are in the interests of consumers (such as protecting carparking and amenities). Furthermore, while "protection of investment" may on its face appear to be for the interest of the business in question, in fact enabling investments in new sites (and, therefore, developing new amenities) is also in the interests of consumers. For example, some form of (potentially time limited) protection of investment in a new site is often necessary to encourage development of new sites and businesses - including new supermarkets. For example:

(a) in the case of a leased premise in a shopping centre, it is the landlord that has control over the commercial environment in the shopping centre (for example, by changing the mix of other tenants and choosing whether or not to invest in the shopping centre

[3] *Woolworths Limited v About Life Pty Ltd* [2017] NSWSC 1117 (24 August 2017).

amenities), however, it is the tenant (who has invested in the fitout and development of the premises) that will bear the commercial consequences of that;

(b) if WWNZ is considering investment in the fitout and development of a new supermarket, but the landlord is retaining discretion over changes to the tenancy mix of the shopping centre from day one, then WWNZ will not have the same commercial certainty on its operating environment to justify the investment in the fitout and development of the site that it otherwise could;

(c) the same equally holds true where, instead of leasing a site, WWNZ is purchasing land for a new supermarket. In those circumstances WWNZ will not have a lease to protect its commercial environment, but where the seller of that land is retaining adjoining property, WWNZ and the seller can agree a covenant on that adjoining land for a short period of time to provide the necessary commercial certainty on WWNZ's operating environment so that it can make the necessary investments.

22. Again, the inclusion of a legitimate business rationale exception (which could be assessed against the duration of the covenant) would avoid a deeming provision from preventing short-term land agreements that are necessary to encourage development of new supermarkets and other businesses, and any such deeming provision could be subject to the substantial lessening of competition prohibition.

23. Such an exception has precedent in New Zealand law, for example the "unconscionable conduct"[4] and "unfair contract terms"[5] prohibitions in the Fair Trading Act provide protections for conduct / contractual terms that are "reasonably necessary for the protection of the trader's legitimate interests". A similar approach should be adopted in relation to land covenants.

EFFECTIVE AUTHORISATION REGIME REQUIRED TO MITIGATE UNINTENDED EFFECTS

24. Question 41 asks if we consider the ability of the Commerce Commission to provide 'authorisation' sufficient to mitigate the risk that the Commerce Act could over-capture land agreements? If not, why not?

25. In our view, as s 28A(7) currently stands, the authorisation regime is insufficient to mitigate the risk that s 28A over-captures land agreements.

26. If the authorisation regime in the Act (which allows a business to apply to the Commerce Commission for authorisation for a contract or covenant on the basis of any wider public interests that outweigh the competition considerations) is to be effective at mitigating against unintended consequences, the Commerce Commission should not be required to take any deemed (as opposed to actual or likely) effects on competition into account.

27. As it currently stands, section 28A(7) provides that, in evaluating an authorisation for such a contract or covenant, the Commission needs to evaluate any lessening of competition as including any "lessening that… must be treated as resulting". That requires the Commission to evaluate potential benefits to the public against deemed (but not necessarily actual or likely) anti-competitive effects. In effect, such an application would not be "considered on its merits", but would be assessed based on a theoretical concern (even if the contract / covenant itself is benign). That seems to be inconsistent with the Commission's obligation to quantify benefits and

[4] Section 8(1)(f).

[5] Section 46L(1)(b).

detriments to the greatest extent possible, and would appear to undermine the purpose of retaining the authorisation regime to mitigate against unintended consequences given even benign contracts or covenants will have to be treated as anti-competitive for the purposes of the Commission's evaluation process.

28. WWNZ submits that it would better enable the authorisation process to act as a safety-valve to mitigate against unintended consequences if the Commission can evaluate an application against "the lessening in competition that would result, or would be likely to result therefrom" (consistent with the default position under s 61(6)).

CONCLUDING COMMENTS

29. WWNZ is grateful for the opportunity to make these submissions. WWNZ hopes that its submissions will assist MBIE to make recommendations that achieve the best policy outcomes for all New Zealand consumers and businesses.